Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 02-6
Request for Review of Decision of the Universal Service Administrator	)	FRN Nos. 299376, 299377, 299378, 299379, 299381, 299382, 299355, 299356, 299359, 299361, 299363, 299365, 299367, 2993368, 299370, 299371, 299372 and 299373
by	)	
Spectrum Communications Cabling Systems, Inc.	)	

REQUEST FOR REVIEW

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SUMMARY

In March 1999, R O P - Riverside County/ Riverside County Office of Education ("Riverside") contracted with Spectrum Communications Cabling Systems, Inc. ("Spectrum") for a variety of services offered through the universal service support mechanism for the schools and libraries ("E-rate Program"). Consistent with FCC and Program rules, Riverside traded in certain equipment and applied the fair market value of that equipment to the non-discounted portion of the services Riverside purchased from Spectrum. Spectrum, based upon its considerable expertise in the purchase and sale of new and used technology equipment, calculated the fair market value of Riverside's trade-in equipment as of March 1999, which served as consideration in the parties' contact. Spectrum's valuation of the equipment was later substantiated through an independent appraisal.

Four years after valuable E-rate services were funded by USAC and provided by Spectrum, the SLD and USAC now contest the E-rate funding granted to Riverside based upon the date of the fair market valuation for the traded-in equipment. Specifically, the SLD and USAC claim, based upon a new Program rule that was adopted years after E-rate services were rendered to Riverside, that the trade-in equipment should have been valued at the time the equipment changed hands or on the first date of the applicable E-rate funding year (July 1, 1999), not when the parties entered into their contract (March 1999).

Riverside and Spectrum complied with all applicable FCC and Program rules that were effective in 1999. At that time, there was little guidance available to E-rate participants regarding the timing of fair market valuations, or valuation methodologies, for trade-in equipment under the E-rate Program. The only policies then in effect required equipment to be

traded in at its fair market value and prohibited the trade-in of equipment that had been previously purchased using Program funds. Riverside and Spectrum complied with both of these requirements, which the SLD and USAC do not dispute.

The SLD and USAC exceeded their authority when they concluded that Riverside and Spectrum were precluded from establishing the fair market value of Riverside's equipment as of the date of contract formation. In 1999, when Spectrum and Riverside entered into their agreement, there was no FCC or Program guidance that addressed *when* the fair market value of traded-in equipment should be determined, and such formal guidance still does not exist today (except in the case of equipment that is valued using a 3-year depreciation analysis). Spectrum only became aware of a potentially new SLD Program rule in March 2003 when Mr. Falkowitz of the SLD contacted Spectrum about the trade-in value of Riverside's equipment. Falkowitz asserted that the FCC had provided the SLD with informal guidance regarding trade-in values which indicated that the fair market value of traded-in equipment could be calculated using the rebuttable presumption that equipment has a useful life of three years. This informal guidance did not direct the SLD to create a new Program rule regarding the timing of fair market valuations for traded-in equipment. It appears USAC has made a policy and created the equivalent of new guidelines regarding the timing of valuations for traded-in equipment in violation of its charter.

The SLD and USAC further exceeded their authority when they applied a new, later-adopted Program rule regarding the timing of fair market valuations for trade-in equipment to E-rate services that were provided years earlier, in 1999-2000. It is a basic tenet of American jurisprudence that new precedent is only applied prospectively. The Commission has long acknowledged this, concluding specifically in the context of the E-rate Program that new policies

and rules apply to applicants on a going-forward basis. It is unreasonable for Riverside and Spectrum, exercising good faith and complying with Program rules and general principles of contract law, to be penalized for acting reasonably under the circumstances in 1999, especially when there was no contrary FCC or Program guidance regarding the date upon which the fair market value of equipment should be established.

If the FCC concludes that E-rate funds in this case were erroneously disbursed, such monies should be recovered from Riverside because it would not have paid for the entire non-discounted portion of the E-rate services it obtained. The Commission has instructed USAC that beneficiaries of any FCC or Program violation should be liable for any reimbursement. The harm from rescinding the monies allocated to Riverside in this case, however, far outweigh any benefit. Accordingly, Spectrum, on behalf of Riverside, requests that the FCC waive any rule violation so that Riverside is not irreparably harmed in this case.

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REQUEST FOR REVIEW

Spectrum Communications Cabling Systems, Inc. ("Spectrum"), pursuant to Section 54.719(c) of the Commission's rules,[1] submits this Request for Review seeking reversal of a decision of the Administrator of the Universal Service Administrative Company ("Administrator" or "USAC" respectively), issued on July 1, 2004,[2] denying Spectrum's December 2, 2003 Letter of Appeal ("Appeal").[3] Spectrum's Appeal sought reversal of a "Recovery of Erroneously Disbursed Funds" letter ("Recovery Letter") issued by USAC's Schools and Libraries Division ("SLD") on October 3, 2003, seeking to rescind more than $700,000 in federal funding that was awarded to R O P - Riverside County/ Riverside County

[1] 47 C.F.R. § 54.719(c).

[2] Letter from the Universal Service Administrative Company to Pierre F. Pendergrass, General Counsel, Spectrum Communications Cabling Services, Inc. (July 1, 2004) ("*Administrator's Decision on Appeal*"), attached hereto as Exhibit 1.

[3] Letter from Pierre F. Pendergrass, General Counsel, Spectrum Communications Cabling Services, Inc., to the Universal Service Administrative Company, Schools and Libraries Division (Dec. 2, 2003), attached hereto as Exhibit 2.

Office of Education ("Riverside") for products and services through the universal service support mechanism for schools and libraries ("E-rate Program").

The SLD specifically seeks to recover from Spectrum $700,000 in E-rate funding that the SLD contends is related to the difference between the fair market value of Riverside's trade-in equipment as of March 1999, when Riverside and Spectrum formed their agreement for E-rate services, and the fair market value of Riverside's trade-in equipment as of July 1, 1999, the beginning of the 1999-2000 funding year. The SLD contends that Spectrum should have assessed the fair market value for the trade-in equipment as of July 1, 1999 based upon a Program rule that was adopted by the SLD roughly 3-4 years after the funding year in question. Spectrum and Riverside followed all FCC and Program Rules related to trade-in equipment that were applicable in 1999 (i.e., the equipment was traded for E-rate services at its fair market value, and the equipment was not previously purchased using E-rate funds). The fair market value assessed for Riverside's trade-in equipment in 1999 was confirmed by an independent appraisal performed in 2003. In the absence of specific FCC or USAC guidance in 1999 regarding the timing of determining the fair market value of trade-in equipment, the parties followed well established principles of contract law and valued the trade-in equipment, which was essential consideration for the E-rate services, at the time of contract formation.

The Commission should overturn USAC's decision and direct the SLD to withdraw the Recovery Letter because: (1) Spectrum and Riverside complied with all FCC and Program rules regarding trade-in equipment that were in effect in 1999; (2) the SLD and USAC exceeded their authority when they adopted a new policy that precludes calculating the fair market value of traded-in equipment at the time Program participants enter into a contract for services; and (3)

the SLD and USAC exceeded their authority by applying this new policy retroactively to Spectrum and Riverside.

I. SPECTRUM'S INTEREST IN THE MATTER PRESENTED FOR REVIEW.

Pursuant to Section 54.719 of the FCC's rules,[4] any party aggrieved by an action taken by the SLD or the Administrator may appeal that decision, including service providers and applicants. Spectrum is an interested party in this case because it is the service provider to whom the SLD issued the Recovery Letter seeking to recoup more than $700,000 in E-rate funding.

II. STATEMENT OF FACTS.

A. Riverside's Request for Funding and Resulting Agreement with Spectrum.

Spectrum, a privately held corporation founded in 1985, is a provider of information technology products and services. The company's customer base consists primarily of the education market, public sector agencies and large healthcare facilities. The company has participated in the E-rate Program since 1998, during which time Spectrum has acted as a service provider for approximately 38 different school districts.

Riverside is a service agency supporting Riverside County's 23 school districts and linking them with the California Department of Education. Riverside provides, among other services, assistance to its member districts in the deployment and maintenance of network and telecommunications services. Approximately 6.1 million students were enrolled in Riverside County in the 2002-2003 school year.

Riverside formed a consortium of its member school districts for the purpose of applying for E-rate Program discounts in the 1999-2000 funding year. On March 5, 1999, Riverside filed a Form 470 soliciting proposals from prospective service providers for a range of eligible E-rate

[4] 47 C.F.R. § 54.719.

products and services. Consistent with Program rules, the Riverside consortium members intended to "trade-in" certain equipment owned by Riverside as consideration for Riverside's non-discounted portion of the E-rate services it was seeking through the Program.

Spectrum submitted a bid proposal in response to Riverside's Form 470 and Riverside subsequently selected Spectrum as the service provider for the consortium. In the absence of specific FCC or USAC guidance on the timing for determining the fair market value of the trade-in, Spectrum assessed the fair market value of the equipment as part of the initial "bid and ask" process at the time of contract formation.

Spectrum calculated the fair market value of Riverside's equipment, based upon its considerable expertise in the purchase and sale of new and used technology equipment in the Riverside market. Specifically, Spectrum: (i) had previously sold and installed the specific pieces of equipment at issue; (ii) was knowledgeable about the manner in which the equipment had been used and maintained; (iii) was knowledgeable about the training and expertise of the staff who had been using the equipment; and (iv) most importantly, had detailed knowledge about the identity and needs of potential buyers of the specific pieces of equipment in question. As discussed in further detail below, Spectrum's valuation of the equipment at the time the parties entered into their agreement in March of 1999 was subsequently substantiated by an independent third-party appraiser.[5]

On April 5, 1999, Riverside filed a Form 471 evincing its acceptance of Spectrum's proposal and its selection of Spectrum as its service provider for the 1999-2000 funding year.

[5] *See* Appraisal Report for Spectrum Communications, DMC Consulting Group (Mar. 2003), attached to Memorandum from Robert Rivera, Spectrum, to Ed Falkowitz, Schools and Libraries Division (Mar. 15, 2003) ("Appraisal Report"), attached hereto as Exhibit 3. The appraiser, in fact, concluded that Spectrum's valuation in March 1999 was slightly *less* than the fair market value of the equipment at that time.

The eighteen funding request numbers ("FRNs") identified in the case caption above are associated with Riverside's and Spectrum's agreement. The total pre-discount value of the agreement for all E-rate services between Riverside and Spectrum was $5,495,471.70. As calculated on the Form 471, Riverside was eligible for a Program discount of 67 percent. Consequently, pursuant to Commission and Program rules, Riverside and/or its consortium members were required to pay 33 percent, or $1,813,505.66, of the total contract price. Some consortium members later decided to retain their equipment and, instead, pay their portion of the contract price in cash. The total amount of cash paid to Spectrum was $155,996.21. The remaining portion of the purchase price owed by Riverside was paid by traded-in equipment.

B. USAC Upheld the SLD's Determination that the Trade-In Equipment was not Valued Appropriately.

The SLD contended that the fair market value of Riverside's traded-in equipment was less than Riverside's non-discounted share for services purchased through the E-rate Program, based upon the date the equipment was valued. USAC, upholding the SLD's determination, stated that:

> [T]he trade-in amount was based on the value of the equipment at the time of the contract, which was before the start of the funding year and several months before Spectrum was set to take possession of the equipment. Spectrum provided an independent appraisal indicating the FMV [fair market value] of the equipment as of July 1, 1999. SLD has accepted this appraisal and determined that the recovery amounts should be based on the date that Spectrum took possession of the equipment, but no earlier than the first day of the funding year.
>
> The FCC has directed USAC "to adjust funding commitments made to schools and libraries where disbursement of funds associated with those commitments would result in violations of a federal statute" and to pursue collection of any disbursements that were made in violation of a federal statute.[6]

[6] *Administrator's Decision on Appeal* at 2.

USAC agreed with the SLD that the appropriate date for valuing Riverside's trade-in equipment was the beginning of the 1999-2000 funding year (July 1, 1999) and not at the time Riverside and Spectrum entered into an agreement for E-rate services (March 1999). Using a valuation date of July 1, 1999, USAC contends that the total fair market value of the consortium's equipment was $1,316,159.[7] This value was based upon a third-party appraisal, which was requested by the SLD as part of an audit in 2003. USAC neglects to mention that it also has an independent appraisal of the fair market value of the trade-in equipment as of contract formation, March 1999, and that this valuation shows that Spectrum's appraisal of the value of the trade-in equipment in March 1999 was the fair market value as required by Program rules that were in effect in 1999. Also, contrary to the *Administrator's Decision on Appeal*, there was no violation of a federal statute in this case, and there certainly was no violation of any applicable FCC or USAC statute, rule or guidance with respect to trade-in equipment that was applicable to Spectrum and Riverside in 1999. The parties complied with all known rules, laws and statutes.

In March 2003, four years after approving Riverside's funding, after valuable E-rate services were provided by Spectrum and received by Riverside, and paid for, in part, through the fair market value of Riverside's trade-in equipment, Ed Falkowitz, an SLD account manager, contacted Spectrum stating that it was conducting an internal audit regarding the trade-in value of Riverside's equipment. To assist the SLD in its investigation, and at the SLD's request, an

[7] Under USAC's calculations, the total amount of matching funds that should have been paid by Riverside was $1,472,155.21 ($1,316,159 in equipment, plus $155,996.21 in cash). Based upon Riverside's 67 percent discount, the payment of matching funds in the amount of $1,472,155.21 would entitle Riverside to an E-rate discount of $2,988,921.18. USAC previously disbursed $3,681,966.04, which is $693,044.96 more than it believes it should have disbursed ($2,988,921.18 in actual disbursements minus $1,472,155.21 in alleged appropriate disbursements). Inexplicably, however, the total amount USAC seeks to recover is $707,521.34 – not $693,044.96.

independent appraisal regarding the value of the equipment was undertaken in 2003 using both the actual appraisal date, March 1999, and July 1, 1999, the date suggested by the SLD. The Appraisal Report valued Riverside's equipment at $1,859,321 in March 1999 and $1,316,159 as of July 1, 1999.[8] The Appraisal Report, which USAC and the SLD accepted as dispositive of the July 1, 1999 valuation, concluded that Spectrum's valuation of the equipment as of March 1999, was entirely consistent with the then-current market.

In valuing the trade-in equipment in 1999, Riverside and Spectrum complied with all Program rules that were effective at that time (*i.e.*, they assessed the appropriate fair market value of the equipment, and they did not trade in equipment that was previously purchased with Program funds). In the absence of specific guidance on when the trade-in equipment should be valued, the parties observed the basic legal principle that essential contract terms, including the consideration for a contract (*i.e.*, the trade-in equipment) must be definite and certain at the time of contract formation. The SLD's and USAC's actions in imposing a new date of valuation, based upon retroactive application of new Program rules, rewrites the essential terms of the agreement (*i.e.*, offer, acceptance and consideration) without the assent of the parties.

C. Commission and SLD Guidance in 1999.

At the time Riverside filed its Form 470 and entered into a contract with Spectrum in 1999, very little guidance was available to participants in the E-rate Program regarding the FCC's and SLD's policy for trading in equipment. Even now, the guidance does not specifically address *when* the fair market value of traded-in equipment should be determined in all cases. Rather, it only addresses fair market value in the case of the SLD's 3-year depreciation value analysis discussed below.

[8] *See* Appraisal Report.

Today, the SLD's website has a page devoted to trading in equipment. That page advises that a Program applicant can trade in equipment and apply the value of that equipment to the non-discounted portion of new products and services that are funded through the E-rate Program.[9] The SLD places certain conditions, however, on trading in equipment: (1) equipment previously purchased with E-rate discounts cannot be used toward payment of an applicant's non-discount share; and (2) the amount credited toward the non-discounted share must be the fair market value or acquisition cost, which ever is lower.[10] The foregoing Program rules were applicable in 1999 when Spectrum and Riverside entered into their agreement for E-rate services. However, with regard to determining fair market value, the Program rules now also state the following:

> There is a rebuttable presumption that technology equipment has a three-year life and that the value declines on a straight-line basis. Therefore, the presumptive value of a component with an original cost of $1000 would be $666 after one year, $333 after two years, and would have no value after three years. Time periods are calculated from the date that equipment was originally delivered to the applicant to the estimated delivery date to the service provider. The applicant or service provider may provide evidence of fair market value to rebut this presumption. Although the form of the evidence is flexible, the best evidence would be from an independent third party source indicating the secondary market prices for the specific make and model of equipment traded in.[11]

As an initial matter, the Program rules regarding timing of valuations and depreciation methodology were not available in 1999. The SLD's guidance at that time was more general, stating only that equipment must be traded-in at its fair market value and that the equipment to be traded could not be equipment previously purchased with Program funds. As discussed

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[9] Universal Service Administrative Company, "Transfer or Trade-in of Components," available at http://www.sl.universalservice.org/reference/epsfaq-f.asp (last modified Feb. 13, 2004).

[10] *See id.*

[11] *Id.*

above, Spectrum and Riverside fully complied with these requirements. Spectrum carefully evaluated Riverside's equipment, which had not been previously purchased with Program funds, at the time they formed their agreement and calculated the fair market value of the equipment based upon Spectrum's considerable expertise in the market. Although the Program rules now explain how and when to assess the fair market value of equipment under the SLD's presumptive 3-year depreciation value analysis, it is devoid of any explanation regarding how or when Program participants should assess the fair market value of equipment using any other analysis. It does not appear that the new Program rule requires, as USAC contends in the *Administrator's Decision on Appeal*, that all valuations for trade-in equipment must be based on the date the service provider takes possession of the equipment, or no earlier than the first day of the funding year. Rather, it appears the new Program rule prescribes the dates to be used for valuing equipment when parties use the 3-year depreciation analysis. Spectrum did not use a 3-year depreciation analysis in the case of Riverside, and thus the new rule is inapplicable. In addition, the new Program rule allows for independent third party appraisals to rebut the SLD's presumptive 3-year depreciation value analysis, which Spectrum provided in this case.

Most importantly in this case, with the exception of requirements for a fair market valuation and a prohibition against trading-in "Program" equipment which Spectrum and Riverside observed, none of the foregoing guidance about the date upon which trade-in equipment should be valued, or valuation methodologies, was available to Spectrum or Riverside in 1999 when Spectrum assessed the fair market value of Riverside's equipment, Spectrum bid for Riverside's E-rate services, Riverside accepted Spectrum's bid, the parties entered into an agreement for services and agreed upon the consideration, the SLD approved Riverside's funding requests, and valuable E-rate services were provided in reliance thereon. Spectrum was

notified of the SLD's new policy only after Mr. Falkowitz from the SLD contacted Spectrum in March 2003.[12] The email correspondence between Mr. Falkowitz and Spectrum, indicates that the only "guidance" the SLD received from the FCC on this issue was that the fair market value of traded-in equipment could be calculated using the rebuttable presumption that equipment has a useful life of three years.[13] It does not appear the FCC addressed the date upon which the fair market value should be determined.

III. QUESTIONS PRESENTED FOR REVIEW.

A. What Was the Required Valuation Date for Equipment that Was Traded-In Through the E-Rate Program in 1999?

Today, the SLD and USAC claim that equipment that is traded in for the purpose of paying an applicant's non-discounted portion of services purchased through the E-rate Program must be valued either at the time the service provider takes possession of the equipment or the first day of the applicable Program funding year. This guidance was not available to Riverside and Spectrum in 1999 and should not be applied retroactively to either devalue services that were already provided in reliance on the former rules and SLD funding grants, or require additional cash consideration from Riverside which it did not agree to pay for E-rate services in 1999. In the absence of specific guidance from the FCC or the SLD, the parties followed basic, well-established principles of contract law when they entered into their agreement for E-rate services and assessed a fair market value for Riverside's traded-in equipment at the time of contract formation. This valuation was later substantiated by an independent third party appraisal. It is also important to note that Riverside and Spectrum were required to assess the fair market value

[12] *See* email from Ed Falkowitz, Accounting Manager, SLD, to John Price, then-present Chief Financial Officer of Spectrum (Mar. 3, 2003), attached as Exhibit 4 hereto.

[13] *See id.*

of the trade-in equipment and agree upon the consideration at the time of contract formation in order to obtain necessary board approvals and meet applicable SLD filing deadlines.

"Under long-standing principles of contract law, three familiar elements are typically required for the formation of a contract: offer, acceptance, and consideration."[14] Consideration is an essential element of a valid contract,[15] and a contract is not enforceable unless its terms and conditions are definite and certain.[16] In the absence of specific FCC or USAC guidance regarding the timing of valuations for trade-in equipment, Spectrum and Riverside used basic principles of contract law and, at the time of contract formation – not an undefined later date -- assigned a fair market value to the trade-in equipment that would be used in lieu of cash. Without an upfront understanding by Riverside and Spectrum of the combination of consideration that would be paid for the E-rate services, and the corresponding payment obligations, the contract would have lacked definite and enforceable terms.

In response to Riverside's Form 470, Spectrum submitted a proposal that would meet the technology plan objectives of the consortium while, at the same time, avoid a significant cash outlay. Riverside reviewed the proposal and found it to be the most cost-effective response to its Form 470. Before agreeing to hire Spectrum, however, Riverside and/or its consortium members were required to obtain school board approval of the proposed contract. It would have been impossible for Riverside and its member districts to have obtained board approval without first

[14] "Government Contract Cases in the United States Court of Appeals for the Federal Circuit: 1996 in Review," C. Stanley Dees and David A. Churchill, 46 Am. U.L. Rev. 1807, 1844 (Aug. 1997) (citing the Restatement (Second) of Contracts, §§ 17(1), 22(1)).

[15] *See, e.g., Agosta v. Astor*, 120 Cal. App. 4th 596, 605 (2004); *Lopez v. Charles Schwab & Co., Inc.*, 118 Cal. App. 4th 1224, 1230 (2004).

[16] *See, e.g., Suffield Development Associates Ltd. Partnership v. Society for Sav.*, 708 A.2d 1361 (1998).

describing in detail the purchase price and the terms (including the amount of cash required) of the agreement, and the E-rate services that would be received in exchange. Consequently, the parties had to value the equipment at the time they reached an agreement.

E-rate Program rules require applicants and service providers to enter into agreements for E-rate services before filing a Form 471.[17] Applicants use the Form 471 to request discounts from the SLD for eligible services, and specific amounts for the cost of the purchased services must be recorded in the Form 471. The agreement necessarily establishes the type and amount of consideration an applicant must pay for the goods and services purchased from a service provider so the applicant can seek the appropriate amount of E-rate support. It would have been impossible in this case for Riverside and Spectrum to predict the value of the equipment at some future date and still comply with USAC's requirement that the agreement be executed and the Form 471 filed by April 6, 1999. If Riverside and Spectrum had waited until the start of the funding year (July 1, 1999) to value the equipment, Riverside would have had to wait to enter into a contract with Spectrum and would have missed the deadline for filing its Form 471.

B. Did the Administrator Exceed its Authority by Creating New Policy and then Applying that Policy Retroactively to Spectrum?

1. The Administrator Exceeded its Authority in Adopting a New Policy Without FCC Guidance.

The FCC appointed USAC to administer the E-rate Program in 1998. USAC's authority over the Program is limited to implementing and applying the FCC's Part 54 rules, and the FCC's interpretations of those rules as found in agency adjudications.[18] USAC is not

[17] Universal Service Administrative Company, Selecting Service Providers, available at: http://www.sl.universalservice.org/reference/selectingsp.asp.

[18] 47 C.F.R. § 54.702(c).

empowered to make policy, interpret any unclear rule promulgated by the FCC[19] or to create the equivalent of new guidelines.[20] The Administrator exceeded its authority in this case by creating a new policy not previously elucidated by the FCC – namely, that the fair market value of traded-in equipment cannot be calculated at the time that an E-rate applicant and service provider execute a contract for E-rate services and products, consistent with basic principles of contract law.

In 1999 when Spectrum and Riverside entered into their agreement, there was no FCC or Program guidance that addressed *when* the fair market value of traded-in equipment should be determined, and such formal guidance still does not exist today (except in the case of equipment that is valued using a 3-year depreciation analysis). Spectrum only became aware of the new SLD Program rule in March 2003 when Mr. Falkowitz contacted Spectrum about the trade-in value of Riverside's equipment.[21] As noted above, however, it does not appear that the FCC gave the SLD specific guidance regarding the date upon which the fair market value should be determined. Rather, the email correspondence between Mr. Falkowitz and Spectrum, indicates that the only "guidance" the SLD received from the FCC on this issue was that the fair market value of traded-in equipment could be calculated using the rebuttable presumption that equipment has a useful life of three years.[22] It appears USAC has made a policy and created the

[19] *Id.*

[20] *Changes to the Board of Directors of the Nat'l Exchange Carrier Ass'n, Inc.*, Third Report and Order, 13 FCC Rcd 25058, 25066-67 (1998) ("*NECA Third Report and Order*").

[21] *See* email from Ed Falkowitz, Accounting Manager, SLD, to John Price, then-present Chief Financial Officer of Spectrum (Mar. 3, 2003), attached as Exhibit 4 hereto.

[22] *See id.*

equivalent of new guidelines regarding the timing of valuations for all traded-in equipment in violation of its charter.

2. The Administrator Exceeded its Authority in Retroactively Applying a Later-Adopted SLD Policy to Previously Granted Funding Requests.

Even assuming, *arguendo*, that the Administrator had authority to adopt the policy that the fair market value of traded-in equipment cannot be determined at the time a contract is executed, the Administrator still exceeded its authority by retroactively applying the policy in this case. In this case, the Administrator is attempting to apply a new Program rule regarding the timing for valuation of trade-in equipment to a contract for E-rate services that was entered into in 1999, and performed in 1999-2000, three years before adoption of the new Program rule.

It is a basic tenet of American jurisprudence that if a court overturns its prior precedent in a line of cases, the new precedent is applied prospectively. The court does not re-open every prior case, retroactively apply the new precedent and overturn all prior concluded decisions.[23] In *RKO General v. FCC*,[24] the U.S. Court of Appeals for the D.C. Circuit addressed retroactive application of new Commission precedent very clearly:

> Although an administrative agency is not bound to rigid adherence to its precedents, it is equally essential that when it decides to reverse its course, it must give notice that the standard is being changed . . . and apply the changed standard only to those actions taken by parties after the new standard has been proclaimed as in effect.[25]

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[23] *See generally* 28 U.S.C. § 2106 ("The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court lawfully brought before it for review.")

[24] *RKO General, Inc. v. FCC*, 670 F.2d 215 (D.C. Cir. 1981).

[25] *Id.* at 223-24, *citing Boston Edison Co. v. PFC*, 557 F.2d 845(D.C. Cir. 1997) *cert. denied sub nom. Towns of Norwood, Concord and Wellesley, Mass. V. Boston Edison Co.*, 434 U.S. 956 (1988).

In addition, "an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy."[26]

The SLD's standard regarding when to evaluate the fair market value of traded-in equipment was expressed to Spectrum only in March 2003 through general correspondence. This standard has not, and even today is not, explicitly stated in any FCC decision or on the SLD's website as a Program rule (except in the case of equipment that is valued using a 3-year depreciation analysis). Even if the FCC finds such a rule is now applicable, consistent with the finding in *RKO*, new or changed standards can be applied prospectively only to pending or future applications, not retroactively to granted applications.

In addition, Spectrum and Riverside detrimentally relied on the FCC and SLD guidance that was available in 1999, and it detrimentally relied on the SLD's grant of Riverside's funding requests under the former rules pursuant to which valuable E-rate services were provided and accepted. It is unreasonable for a Program participant, exercising good faith and complying with all applicable Program rules and general principles of contract law, to be penalized for acting reasonably under the circumstances, especially when there was no contrary FCC or USAC guidance specifying the date on which the fair market value of traded-in equipment should be assessed. Riverside and Spectrum had no other recourse but to reasonably assume the equipment should be valued at the time the agreement was formed.

There is an extensive body of judicial case law regarding impermissible retroactivity in which the courts discuss basic notions of equity and fairness and detrimental reliance by citizens

[26] *New England Telephone and Telegraph Co. v. FCC*, 826 F. 2d 1101, 1110 (D.C. Cir. 1987) *citing RKO General*, 670 F.2d at 223.

on prior agency policies.[27] There is no need to present a full discussion of such retroactivity here, as the FCC's own decisions in prior SLD matters reflect its own concern about the retroactive application of new precedent.

In a November 5, 1999 FCC decision involving the E-rate Program, the Commission considered a case in which the Prairie City School District ("Prairie City") sought review of an

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[27] *See Bowen v. Georgetown University Hospital*, 488 U.S. 204, 224 (1988) (J. Scalia concurring) ("[W]here legal consequences hinge upon the interpretation of statutory requirements, and where no preexisting interpretive rule construing those requirements is in effect, nothing prevents the agency from acting retroactively through adjudication."). *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 293-294 (1974); *SEC v. Chenery Corp*., 332 U.S. at 194, 202-03 (1947). *See also Verizon Telephone Co. v. FCC*, 269 F.3d 1098 (2001) ("[T]he governing principle is that when there is a 'substitution of new law for old law that was reasonably clear,' the new rule may justifiably be given prospectively-only effect in order to 'protect the settled expectations of those who had relied on the preexisting rule."); *Id.* at 1109, *citing Williams Natural Gas Co. v. FERC*, 3 F.3d 1544, 1554 (D.C. Cir. 1993)). Moreover, retroactivity will be denied "when to apply the new rule to past conduct or to prior events would work a manifest injustice." *Id. citing Clark-Cowlitz Joint operating Agency v. FERC*, 826 F.2d 1074, 1081(D.C. Cir. 1987). To determine whether a manifest injustice will result from the retroactive application of a statute, a court must balance the disappointment of private expectations caused by retroactive application against the public interest in enforcement of the statute. *Demars v. First Serv. Bank for Sav*., 907 F. 2d 1237, 1240 (1st Cir. 1990) (*citing New England Power v. United States*, 693 F. 2d 239, 245 (1st Cir. 1982)). The D.C. Circuit Court notes that it has not been entirely consistent in enunciating standards to determine when to deny retroactive effect in cases involving "new application of existing law, clarifications and additions" resulting from adjudicatory actions. In *Cassell v. FCC*, the court acknowledges that it has used the five-factor test set forth in *Clark-Cowlitz* as the "framework for evaluating retroactive application of rules announced in agency adjudications." *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) *citing Clark-Cowlitz*, 826 F.2d at 1081. In a subsequent case, the court substituted a similar three-factor test. *See Dist. Lodge 64 v. NLRB*, 949 F.2d 441, 447 (D.C. Cir. 1991) (*citing Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971)). Today, the court has moved from multi-pronged balancing tests for impermissible retroactivity in favor of applying basic notions of equity and fairness. *See Cassell*, 154 F.3d at 486 (declining to "plow laboriously" through the *Clark-Cowlitz* factors, which "boil down to a question of concerns grounded in notions of equity and fairness"); *PSCC v. FERC*, 91 F. 3d 1478, 1490 (concluding that "the apparent lack of detrimental reliance . . . is the crucial point [supporting retroactivity]"). In *Chadmoore Communications, Inc. v. FCC*, the court stated that the test it commonly uses to determine whether a rule has retroactive effect is if "it does not impair [ ] rights a party possessed when it acted, increase [ ] a party's liability for past conduct, or impose [ ] new duties with respect to transactions already completed." *Chadmoore*, 113 F.2d 235, 240 (D.C. Cir. 1997), *citing DIRECTV, Inc. v. FCC*, 110 F. 3d 816, 825-26 (D.C. Cir. 1997) (*quoting Landgraf v. USI Film Prods.*, 511 U.S. 244, 280 (1994)).

SLD denial of its application for universal service support.[28] Prairie City argued that the SLD's denial should be overturned because Prairie City filed its application in reliance on filing guidelines provided by the SLD on its website. The FCC agreed with Prairie City and directed the SLD to issue a new funding commitment decision letter. Citing *Williamsburg-James City*, the FCC found that where an application was submitted before the establishment of a particular and applicable rule, the applicants could not have been aware of the application requirements.[29]

The FCC also has recognized that clarifications of its universal service policies are to be applied prospectively only by the SLD. In *Ysleta*[30] and *Winston-Salem*[31] the FCC clarified that a party submitting a bona fide service request under the E-rate Program must provide a Form 470 that lists the specific services for which the applicant anticipates seeking E-rate discounts, rather than a Form 470 that listed every service or product eligible for discounts.[32] The FCC, however,

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[28] *Request for Review of the Decision of the Universal Service Administrator by Prairie City School District*, 15 FCC Rcd 21826 (CCB 1999).

[29] *Id.* at 21827, citing *Request for Review of the Decision of the Universal Service Administrator by Williamsburg-James City Public Schools*, 14 FCC Rcd 20152, 20154-55 (1999) ("Williamsburg could not have been aware of the rules of priority at the time it filed its application." Williamsburg's application was also remanded for reprocessing and issuance of a new funding commitment decision letter. The applicant submitted its application in April of 1998 and new rules were adopted by the Commission in June of 1998.).

[30] *Request for Review of the Decision of the Universal Service Administrator by Ysleta Independent School District, El Paso, Texas*, 18 FCC Rcd 26406 (2003) ("*Ysleta*"). In *Ysleta* the Commission addressed multiple requests to review the decisions of the SLD that were filed by E-rate applicants, but combined the requests as they had almost identical fact patterns.

[31] *Request for Review of the Decision of the Universal Service Administrator by Winston-Salem/Forsyth County School District, Winston-Salem, North Carolina*, 18 FCC Rcd 26457 (2003) ("*Winston-Salem*").

[32] *Ysleta*, 18 FCC Rcd at 26419-23; *Winston-Salem*, 18 FCC Rcd at 26462.

did not invalidate the applicants' applications based upon this error.[33] It acknowledged that the SLD had previously granted similar funding requests and that Program participants could have reasonably relied on those approvals.[34] The FCC determined that such all-inclusive Form 470s "should not be permitted on a going-forward basis."[35] The FCC therefore "clarif[ied] prospectively that requests for service on the FCC Form 470 that list all services eligible for funding under the E-rate Program do not comply with the statutory mandate."[36] The FCC in *Ysleta* also provided additional guidance regarding other aspects of the E-rate Program rules "to provide greater clarity to *those applicants re-bidding services and future applicants.*"[37]

It is clear that the FCC intended for its precedent in *Ysleta* and *Winston-Salem* to apply to pending or future applications and not applications that have already been granted and funded. Similarly, the FCC should conclude that the SLD cannot retroactively apply the Administrator's new Program rule regarding the timing of valuing traded-in equipment to Spectrum's case. Riverside's funding requests were approved long before the SLD notified Spectrum of its new

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[33] The Commission did conclude in *Ysleta* that the applicants violated the E-rate Program's rules, although not because of the broad list of services included in the applicants' Form 470s. *Ysleta*, 18 FCC Rcd at 26420-21.

[34] *Ysleta*, 18 FCC Rcd at 26422; *see also Winston-Salem*, 18 FCC Rcd at 26462.

[35] *Ysleta*, 18 FCC Rcd at 26422; *see also Winston-Salem*, 18 FCC Rcd at 26462.

[36] *Ysleta*, 18 FCC Rcd at 26422-23 (citation omitted); *see also Winston-Salem*, 18 FCC Rcd at 26462.

[37] *Ysleta*, 18 FCC Rcd at 26433-34 (emphasis added). The Commission also noted that the "SLD will carefully scrutinize *applications*" to ensure that they comply with the clarifications elucidated in this case. *Id.* at 26435 (emphasis added). If the Commission wanted the SLD to apply those clarifications retroactively to prior SLD decisions, it would have specifically directed the SLD to do so. The FCC also rejected the argument that it could not apply the E-rate Program rules to the applicants' pending funding requests in a adjudicatory context. According to the FCC, "[t]he fact that in prior years, [the SLD] did not disapprove applications that utilized the procurement processes at issue in no way limits our discretion to apply our *existing rules*." *Id.* at 26433 (emphasis added).

Program rule. Furthermore, the FCC has never determined that the fair market value of traded-in equipment cannot be established at the time a contract is formed. Spectrum and Riverside (and possibly other E-rate participants) relied on the FCC and SLD rules, and interpretations thereof, which were current in 1999, and reasonably interpreted them to support their valuation of the traded-in equipment at the time of contract formation. The rules in 1999 required a fair market valuation for Riverside's equipment and, as the independent third party appraisal confirms, Spectrum assessed a fair market value for the Riverside equipment.

The FCC also must consider the long term impact on the E-Rate Program if it does not reverse the Administrator's decision in this case. Specifically, it will raise serious questions for other participants in the E-rate Program about whether they can ever rely upon actions taken by the SLD. Allowing the Administrator's decision to stand would mean that the SLD and the Administrator can adopt new policies at will and retroactively deny previously granted applications based upon those new policies after the applications are approved. In the face of such regulatory uncertainty, service providers could certainly conclude that the risk of devoting resources to provide E-rate services is too great. Schools, libraries, students and faculty would be those that ultimately suffer.

3. The Administrator has Advocated Applying Only Program Rules Relevant to a Particular Funding Year to Its Own Audits.

The concept of the SLD applying E-rate Program rules that were in effect only for a particular funding year to judge compliance with its program is something USAC, itself, has advocated for its own audits of E-rate Program compliance. In USAC's November 26, 2003 report to the Commission entitled "*Task Force on the Prevention of Waste, Fraud and Abuse,*" the Task Force recommends that it develop audit policies that:

> reflect compliance with the rules that existed during the funding year to which the funding was associated and to better communicate the degree of

> program compliance . . . The Task Force believes that program audits, which are a necessary part of waste, fraud and abuse prevention, need to focus on the policies, procedures, eligible services, etc., that existed during the funding year that is being audited. Measuring program compliance against policies, procedures, eligible services, etc. which were not in place during a particular funding year is inherently unfair and invalid.[38]

This approach should apply equally to participants in the E-rate Program like Riverside and Spectrum. The SLD's new policy regarding when traded-in equipment should be valued, should not be used as the filter through which Spectrum's and Riverside's 1999 agreement is judged. Spectrum and Riverside complied with all Program rules applicable to trade-in equipment that were effective in 1999.

C. If the FCC Concludes that E-Rate Funds Were Erroneously Disbursed, Should the SLD Seek Reimbursement from Riverside or Spectrum?

Assuming *arguendo* that the proper valuation date for Riverside's traded-in equipment was July 1, 1999, then Riverside would not have paid its entire non-discounted portion of the E-rate funded services it obtained from Spectrum. Accordingly, if the FCC should conclude that E-rate funds were, in fact, erroneously disbursed in this case as a result of the use of an incorrect

[38] *Recommendations of the Task Force on the Prevention of Waste, Fraud and Abuse*, CC Docket No. 02-6 at 10 (Nov. 26, 2003). The Task Force also makes a number of other recommendations to improve the schools and libraries program, concluding that "the program's competitive bidding process is not working as effectively as policy makers had intended." *Id*. at 5. "The Task Force believes there needs to be greater clarification of program rules, along with increased strong program support staff and educational outreach to further ensure optimal usage of program resources." *Id*. "Prior to the start of the annual training cycle, the SLD needs to provide clear policy, procedures, eligible services list, etc. for the upcoming program year and work to minimize the need for clarifications of the rules during the Program Integrity Assurance review process." *Id*. at 6. "The Task Force believes that if applicants have a better understanding of the rules and standards that will be applied, they will be better equipped to obey them. Providing clarity at the beginning of the cycle will also help avoid the waste associated with pursuing appeals that result from a misunderstanding of the rules." *Id*.

valuation date, the FCC should conclude that Riverside is responsible for any unpaid monies that are the result of it not paying the non-discounted portion of the E-rate services it purchased.[39]

The *Administrator's Decision on Appeal* notes that the FCC requires all erroneous disbursements to be collected from service providers.[40] However, the Commission instructs USAC to recover such funds from "whichever party or parties has committed the statutory rule or violation."[41] The duty to pay the undiscounted portion is solely Riverside's responsibility.[42] In fact, USAC rules expressly prohibit the service provider from taking any action that would eliminate or lessen the applicant's obligation to pay the entire undiscounted portion. Consequently, any failure to pay the undiscounted portion would constitute a Program violation by Riverside, the beneficiary of the E-rate services.

D. If the FCC Concludes that E-Rate Funds Were Erroneously Disbursed, Do the Facts in this Case Warrant a Waiver of the SLD's New Policy?

Spectrum and Riverside complied with all applicable FCC and Program rules when they valued Riverside's trade-in equipment at the time they contracted for services through the E-rate Program (i.e., they did not trade-in equipment that was previously funded through the E-rate Program, and the equipment was traded-in at its fair market value). If, however, the Commission determines that the SLD and USAC correctly determined that the valuation timing utilized by

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[39] Upon receiving the Recovery Letter, Spectrum promptly discussed it with Riverside and informed it that Spectrum would: (i) appeal it to USAC and, if necessary, the FCC; and (ii) invoice Riverside for the shortfall in matching funds in the event Spectrum's appeals are denied. In the event the Commission agrees with USAC's determination that funds were erroneously disbursed, RCOE should immediately be given an opportunity to pay the invoice from Spectrum.

[40] *See Administrator's Decision on Appeal* at 2 (citing *Changes to the Board of Directors of the National Exchange Carrier Association*, FCC 99-291 ¶ 9 (1999)).

[41] Fe*deral-State Joint Board on Universal Service*, Order on Reconsideration and Fourth Report and Order, FCC 04-181, CC Docket Nos. 96-45, 97-21, 02-6 at ¶ 1 (rel. July 30, 2004).

[42] *Id.* ¶¶ 13, 15.

Spectrum and Riverside was incorrect based upon a new Program rule and, as a result of this retroactive analysis, Riverside may not have paid the entire non-discounted portion of the services it purchased from Spectrum, then Spectrum requests that the Commission grant a waiver in this case on Riverside's behalf. Riverside should not be forced to pay additional cash consideration for 1999-2000 E-rate services at this time. Had Riverside known that additional cash consideration would be required, it likely would not have contracted for all of the E-rate services it received from Spectrum in the 1999-2000 Program year. As further discussed below, the harm resulting from rescinding the monies allocated to Riverside, or requiring additional cash consideration, far outweighs any purported benefit in denying the waiver, and grant of the waiver is in the public interest.

Pursuant to Section 1.3 of its rules, the FCC may waive one of its rules or procedures when good cause is shown.[43] The U.S. Court of Appeals for the District of Columbia has found that a waiver is appropriate "if special circumstances warrant a deviation from the general rule and such deviation will serve the public interest."[44] Furthermore, there must be a rational policy supporting the grant a waiver.[45] In reviewing a waiver request, the Commission also can weigh "considerations of hardship, equity, or more effective implementation of overall policy."[46] Spectrum's waiver request meets this standard and should therefore be granted.

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[43] 47 C.F.R. § 1.3.

[44] *Northeast Cellular Telephone Co. v. FCC*, 897 F.2d 1164, 1166 n.3 (D.C. Cir. 1990) ("*Northeast Cellular*"); *see also WAIT Radio v. FCC*, 418 F.2d 1153, 1159 n.8 (D.C. Cir. 1969) ("*WAIT Radio*").

[45] *Northeast Cellular*, 897 F.2d at 1166; *WAIT Radio*, 418 F.2d at 1159.

[46] *WAIT Radio*, 418 F.2d at 1159 n.8.

Grant of a waiver in this case will serve the public interest. As previously discussed, there is no way Riverside or Spectrum could have known in 1999 that determining the fair market value for the trade-in equipment at the time of contract formation could be later considered unlawful. The critical public interest policies served by the FCC's and the SLD's rules are to ensure that schools and libraries seeking support through the E-rate Program obtain the most cost-effective services available, thereby lessening applicants' demands on universal service funds and increasing funds available to other applicants.[47] Through Riverside's competitive bidding process, there was fair and open competitive bidding for services, and at the end of the bidding process, Spectrum was found to be most cost-effective choice. As demonstrated above, Riverside did not receive any "free" services from Spectrum, and paid the non-discounted portion of such services with a combination of cash and by trading-in valuable equipment.

The failure to grant a waiver will result in irreparable harm to Riverside. The SLD's Recovery Letter was issued years after the SLD reviewed and approved Riverside's application and Riverside paid monies and traded-in equipment for E-rate services for the 1999-2000 funding year. Services were provided by Spectrum and paid for by Riverside years ago in accordance with all applicable Program rules. Accordingly, if a waiver is not granted, Riverside, who in all likelihood does not have funding in its budget to pay for services rendered years ago, will have to reimburse the monies to SLD. The students and faculty of Riverside will thus be irreparably harmed, which is in direct conflict with the purposes of the E-rate Program.[48]

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[47] *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, 9029 (1997).

[48] Although the Commission has considered and rejected waiver requests in prior appeals of SLD funding decisions, the facts of this case are clearly distinguishable from those prior decisions. For example, in *MasterMind*, the SLD denied requests for funding that it had yet to allocate to applicants. *See, e.g., Request for Review of Decisions of the Universal Service Administrator by*

The Commission has previously granted waiver requests "in light of the uncertain application of our rules to the novel situation presented."[49] For example, in *Ysleta* the Commission directed the SLD to allow certain applicants to reapply for E-rate discounts, even though the Commission concluded that the applicants violated the E-rate Program's competitive bidding process by using a certain template approach.[50] According to the Commission, a waiver was appropriate in *Ysleta* because the applicants were likely confused by the application of a new rule to the novel facts presented in that case.[51] The Commission should similarly conclude that a waiver is appropriate here because the SLD is applying a new Program rule in this case to rewrite an agreement that was entered into in 1999 in compliance with all known FCC and USAC rules.

IV. RELIEF SOUGHT AND CONCLUSION.

Spectrum requests that the FCC reverse the Administrator's decision denying Spectrum's Appeal and direct the SLD to withdraw the Recovery Letter it issued to Spectrum. If, however, the FCC does not overturn the Administrator's decision, the SLD should seek to recover any funds owed from Riverside. Because the harm in rescinding Riverside's funding would

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MasterMind Internet Services, Inc., 16 FCC Rcd 4028, 4035 (2000). The end result in that case was only that the applicant had to wait another year to apply for and receive funding for services supported by the E-rate Program. In contrast, in the case of Riverside and Spectrum, the SLD has already reviewed, granted and allocated funds pursuant to Riverside's Form 470 and Spectrum has already provided services under that grant. To now reverse the SLD's prior approvals and reclaim amounts already paid would be patently unfair and irreparably harm Spectrum and Riverside.

[49] *Ysleta*, 18 FCC Rcd at 26437.

[50] *Id.* at 26436.

[51] *Id.* at 26437.

outweigh any benefits, Spectrum also requests a waiver of the E-rate Program's rules on Riverside's behalf.

Respectfully submitted,

/s/ Pierre Pendergrass

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August 30, 2004

CERTIFICATE OF SERVICE

I, Pierre Pendergrass, certify on this 17th day of August, 2004, a copy of the foregoing Request for Review has been served via first class mail, postage pre-paid, to the following:

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